

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
SENIOR HOUSING PROGRAM**

August 16, 2004

This Policy is effective immediately upon adoption and supersedes all previous senior housing real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Senior Housing Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with senior housing investment.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return possible, consistent with a prudent level of risk, the liabilities of the system, and investment guidelines contained herein is the strategic objective of the Program.

The Program shall be considered a component of the Specialized Equity Real Estate Portfolio and, as such, shall be required to achieve an appropriate risk-adjusted return. The Program shall be managed to assist the System in achieving its overall long-term objective of exceeding a minimum target real rate of return of 6% (after fees) while maintaining a prudent level of risk.

The Program shall be managed to accomplish the following:

- A. Preserve investment capital;
- B. Generate attractive risk-adjusted rates of return for the System as a total return investor;
- C. Provide a hedge against inflation; and
- D. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. INVESTMENT APPROACHES AND PARAMETERS

A. Risks

There are specific risks associated with investment in the senior housing industry, which shall be carefully mitigated and monitored by the System. The primary risks include, but are not limited to, the following:

1. Regulatory Risk – Regulatory and reimbursement requirements of the industry are complex. Preference to private-pay properties shall mitigate exposure to pertinent reimbursement regulations.
2. Operating and Business Risk – Senior housing is an operating service business as well as a real estate investment. The risk shall be mitigated by careful selection of experienced, professional [operators](#) who are licensed if required by law.

B. Diversification

The Program shall be well diversified to minimize risk due to overexposure to any one risk factor. The Program shall be diversified by geography, product type, investment manager, and operator. From time to time, adjustments to correct the actual investment to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

The System shall periodically review the Portfolio and Guidelines. The System shall notify the partners when the Portfolio violates diversification guidelines or portfolio leverage.

1. Diversification by Geography

The Program shall diversify by geography. Major urban and suburban markets and submarkets shall be considered, but not more than 33% shall be invested in any single Metropolitan Statistical Area (MSA).

2. Diversification by Product Type

The System shall employ three product types for Program investment. Allocation ranges for each product type have been established as follows:

<u>Product Type</u>	<u>Allocation Range</u>
Independent Living	0 – 75%
Continuing Care Retirement Communities	0 – 65%
<u>Assisted Living</u>	0 – 40%

3. Diversification by Operator

“Operator” refers to any individual, partnership, limited liability company or other entity employed to manage the Senior Housing projects’ day-to-day business and affairs on behalf of the Partnership.

The Program shall consider diversifying among various Operators to avoid business risk associated with a single entity. Operators shall represent expertise in a range and diversification of product types. The selection of Operators shall be based on financial strength and industry expertise. The desired operators shall be leading companies with at least three years’ experience in the senior housing industry.

No more than 33% of total capital shall be committed to any one operator.

4. Diversification by Investment Manager

The Program shall diversify investments such that no one-investment manager shall dominate.

C. Investment Objectives and Criteria

1. Independent Living Facilities

a. “Independent Living Facilities” refers to properties that include multi-unit residential facilities for senior citizens where most residents receive supportive hospitality services such as meals, housekeeping, transportation, and social programs, as well as not more than minimal assistance with daily living activities.

b. Investment Criteria

(1) Age of Buildings: No more than 25 years, unless a redevelopment/rehab is contemplated or has been completed since construction or the property possesses an infill location;

- (2) Location: Strong preference for proximity to health care providers and public transportation if not otherwise provided by the facility;
- (3) Size: 100 units or greater;
- (4) Minimum Square Footage: Studio, 1BR, 2BR – no units below 350 square feet;
- (5) Amenities: Adequate public facilities for recreation and meals;
- (6) Care Continuum: Preference for assisted living units to provide continuum of care; and
- (7) Each project shall be required to produce a projected minimum total real rate of return (after fees) of 6%.

2. Assisted Living Facilities

- a. “Assisted Living Facilities” refers to properties that include multi-unit residential facilities for senior citizens where most residents receive supportive hospitality services such as meals, housekeeping, transportation, and social programs, as well as 24-hour protective Oversight and significant assistance with daily living activities.
- b. Investment Criteria
 - (1) Age of Buildings: No more than 12 years, unless a redevelopment/rehab is contemplated or has been completed since construction or the property possesses an infill location;
 - (2) Location: Strong preference for proximity to health care providers;
 - (3) Size: 40 units or greater;
 - (4) Minimum Square Footage: 1BR, 2BR – no units below 250 square feet;
 - (5) Amenities: Adequate public facilities for meals;
 - (6) Care Continuum: May or may not include Alzheimer’s care units; and

- (7) Each investment shall be required to produce a projected minimum total real rate of return (after fees) of 7%.

3. Continuing Care Retirement Facilities

- a. [“Continuing Care Retirement Community”](#) refers to multi-unit residential communities for senior citizens that are comprised of [Independent Living](#) units, Assisted Living units and units designed for providing skilled nursing care.
- b. Investment Criteria
 - (1) Age of Buildings: No more than 30 years, unless a redevelopment/rehab is contemplated or has been completed since construction or the property possesses an infill location;
 - (2) Location: Strong preference for proximity to health care providers;
 - (3) Size: 175 units or greater;
 - (4) Minimum Square Footage: Mix of Independent Living, Assisted Living, and Skilled Nursing units whereby Independent Living typically comprises the greatest component of units;
 - (5) Amenities: Adequate public facilities for recreation and meals; and
 - (6) Each investment shall be required to produce a projected minimum total real return (after fees) of 7%.

D. Structure

1. Leverage

The System desires an appropriate and diversified use of leverage. A range of leverage at investment level and entity level may be used by the System’s partners.

The maximum amount of leverage on the Portfolio shall be 65% loan to market value.

2. Equity Co-investment

Equity requirements shall be set by the Program Guidelines. The System recognizes that the financing markets for senior housing projects are dynamic; therefore, the System shall review and reconsider the equity requirements, as set forth in the Program Guidelines, every six months.

E. Investment Vehicles

Limited Partnerships, limited liability companies, Real Estate Operating Companies, commingled funds, and separate accounts shall all be considered appropriate investment vehicles for implementing investments in this property type. In all cases, the System's investment and risk of loss shall be limited to the amount initially committed. The System and its partners shall structure transactions and utilize vehicles to minimize tax-related issues.

IV. PARTNER RESPONSIBILITIES

A. Definition

Partnership refers to the limited partnership or limited liability company or other entity formed to manage the Portfolio's business and affairs. The System shall be a limited partner or member. The managing member or general partner shall be responsible for the day-to-day business and affairs of the Portfolio on behalf of the Partnership.

B. Responsibility

The partner responsibilities shall include the fiduciary responsibility to invest and manage the System's funds in this property type in a manner consistent with the Program Guidelines as revised from time to time (in effect at the time each project commitment is made by a partner), and within the limits set by this Policy.

C. Discretion

The partners have investment discretion regarding all project investment decisions; however, they shall comply with the stipulations outlined in the Policy regarding System approvals.

D. Reporting

The System shall require that the partners make periodic reports as requested. The System shall also have the right to audit and review the

books, records, and operations of the partners. Such reviews may be conducted either by the System Staff or by consultants at the System's discretion.

E. Conflicts of Interest

The Partners shall fully disclose to the System any existing relationships that may be conflicts of interest as part of the Partners' standard reporting procedures.

V. GENERAL

Investment in the Program shall include direct or partnership investments where the predominant end use is residential age-restricted facilities including Independent Living, Assisted Living and Continuing Care Retirement Communities (CCRC). Incidental commercial/multi-family infrastructure lot development, including golf course construction, may be undertaken in the Senior Housing Program with certain restrictions.

VI. ASSET ALLOCATION

The following is the current asset allocation range for the Program, as a percent of the total allocated Specialized Equity Real Estate Portfolio:

	<u>Range</u>
Senior Housing Program:	0 – 15%

From time to time, the actual investment may fall out of the range prescribed by Policy. In these instances, adjustments to correct the actual to comply with the Policy allocation range shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

VII. PROJECT MANAGEMENT

Management Firms and Partners shall represent the System's interests in project management decisions and oversee or provide daily project management services, as expertise and organizational structure allows, and act in a fiduciary capacity. The System shall give appropriate Delegation of Authority and provide adequate measures of accountability to Management Firms and Partners.

VIII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms is referenced in the CalPERS Master Glossary of Terms.